

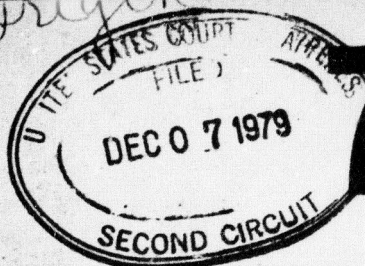
***United States Court of Appeals  
for the Second Circuit***



**APPELLANT'S  
BRIEF**







w/ affidavit KB p/s

# 77-6153

To be argued by  
NAOMI REICE BUCHWALD

## United States Court of Appeals FOR THE SECOND CIRCUIT Docket No. 77-6153

BRISTOL LABORATORIES DIVISION OF  
BRISTOL-MYERS COMPANY,

*Plaintiff-Appellee,*

—v.—

ELMER B. STAATS, COMPTROLLER GENERAL  
OF THE UNITED STATES,

*Defendant-Appellant,*

—and—

UNITED STATES OF AMERICA,

*Intervenor-Defendant-Appellant.*

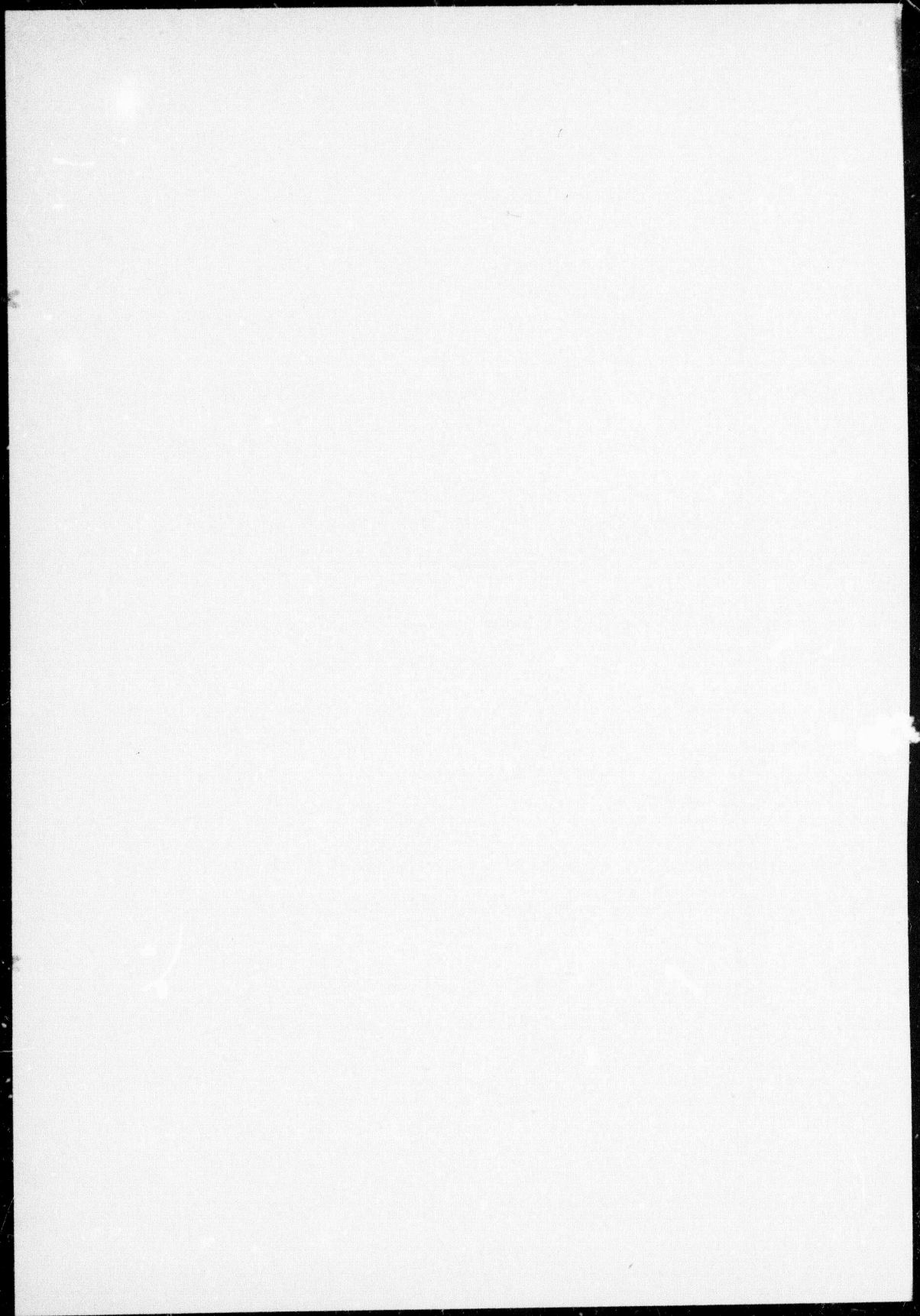
ON APPEAL FROM THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF NEW YORK

### BRIEF OF APPELLANTS, COMPTROLLER GENERAL OF THE UNITED STATES AND THE UNITED STATES OF AMERICA

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12-7-79



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—v.—

ELMER B. STAATS, COMPTROLLER GENERAL  
OF THE UNITED STATES,  
*Defendant-Appellant,*

—and—

UNITED STATES OF AMERICA,  
*Intervenor-Defendant-Appellant.*

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**BRIEF OF APPELLANTS, COMPTROLLER GENERAL OF  
THE UNITED STATES AND THE UNITED STATES OF  
AMERICA**

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**Preliminary Statement**

This is an appeal by the defendant, Elmer B. Staats, Comptroller General of the United States,\* and the Intervenor-Defendant, the United States of America,

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\* The Comptroller General of the United States controls and directs the General Accounting Office ("GAO") which is independent of the executive departments. 31 U.S.C. § 41.

(hereinafter referred to as "the Government") from a judgment of the United States District Court for the Southern District of New York, Lasker, J., entered and filed on July 15, 1977 (A4-A6), granting the motion of plaintiff-appellee, Bristol Laboratories Division of Bristol-Myers Company ("Bristol"), for summary judgment, denying the Government's cross-motion for summary judgment and directing limited access to Bristol's books and records. Entry of judgment followed the District Court's issuance of a memorandum opinion, dated April 7, 1977 and filed April 11, 1977 (A7-A17). That opinion is reported at 428 F. Supp. 1388. Timely notices of appeal were filed by both parties (A182-A183; R39). Thereafter, by Order of this Court dated November 14, 1977 the case was remanded to the District Court for consideration of Bristol's request for a protective order, without prejudice to the pursuance of the appeals from the July 15, 1977 judgment after completion of the proceedings on remand (A3). Following the remand Order of this Court, the parties entered into negotiations with respect to a protective order, culminating in the signing of a protective order on consent which was "So Ordered" by the District Court on September 6, 1979 (A184-A187). Thereafter, Bristol withdrew its notice of appeal, which had been predicated on the absence of a protective order.

### **Issue Presented**

Whether a statutorily required contractual provision granting the Comptroller General access to "directly pertinent" records "involving transactions related to this contract" permits the Comptroller General to examine records of corporate costs and records in support of prices charged to the Government such as would permit representatives of the Comptroller General of the United States to review the prices charged the Government under the contract.



## Statement of the Case

### A. Nature of the Case and Proceedings to Date

This action, commenced by Bristol in 1975, sought declaratory and injunctive relief against the Comptroller General of the United States to limit his right of access to and examination of books and records of Bristol pertaining to contracts for the sale of pharmaceuticals to two federal agencies (A24-A28). A counterclaim was filed by the United States as Intervenor-Defendant to enjoin Bristol from refusing to permit the Comptroller General access to examine records that he had requested pursuant to both his statutory right of access to records and contractual provisions incorporating that statutory access right (A42-A50). In 1975 both parties moved for summary judgment (A63-A118). By decision dated December 31, 1975, the District Court denied the parties' cross-motions for summary judgment on the ground that insufficient information had been presented with respect to Bristol's accounting procedures (A18-A23). The Court directed that the Government take the deposition of a representative of the Bristol Laboratories, which was done on April 5, 1976 (A119-A173). Thereafter, both parties renewed their motions for summary judgment (A174-A181) and the District Judge filed his memorandum opinion on April 11, 1977 (A7-A17). Judgment was entered pursuant thereto on July 15, 1977 (A4-A6). It is from that judgment that the Government appeals.

The dispute between the parties is clearly drawn: it concerns whether the Government is entitled, under the applicable statutes and contracts, to access to Bristol's records relating to expenses incurred for research and development; advertising and promotion; general administration and distribution. Bristol does not assign these costs to particular contracts or products and contends that they are "too remote to the contracts and have only the most general relation, if any, to the prices

charged." 428 F. Supp. at 1390 (A10-A11). On the other hand, the Government submits that the statute grants access, at least in the pharmaceutical area, to those records which Bristol is withholding, because these are major cost items without which the Comptroller General cannot fulfill his statutory mandate to determine whether the Government is paying too much for the items purchased under the contracts.

### **B. The Decision Below**

The District Court rejected the Government's position as too all-inclusive, finding it to be inconsistent with what the District Court termed the "words of limitation" in the statutes providing for access. Moreover, analysing the issue as one of contractual construction, the District Court concluded that Bristol could not have understood the clause as providing for the access now sought by the Government.

Although the District Court stated that the scope of the statutory phrase "directly pertinent records involving transactions related to the contract" "should not depend entirely on a contractor's bookkeeping method, i.e., whether it does or does not assign particular costs to particular contracts or products," (428 F. Supp. at 1391; A15) nevertheless the Court held that the Government could not review corporate records reflecting the costs of research and development, marketing and promotion, and distribution and administration, relying principally upon the fact that Bristol's system of accounting did not assign these costs to specific products and did not take them into account in setting prices. *Id.* In so holding, the Court determined that the GAO's right of access in this case was no greater than that which Bristol had been willing to provide. Ordering paragraph (3) of the Judgment reflects the records to which the Government has been granted access and paragraph (4) the records to which the Government may not gain access (A5).

### C. Statement of Facts

The facts in this case are essentially undisputed and are reflected in the Rule 9(g) Statements filed by Bristol below (A65-A67; A115-A116; A180-A181) and in the Government's Rule 9(g) Statements (A111-A114; A176-A177). During 1973 and 1974 Bristol entered into one negotiated fixed-priced contract with the Veterans Administration,\* and three negotiated fixed-priced contracts with the Defense Supply Agency of the Defense Department. The contract prices totalled approximately \$2,000,000. As required by statute,\*\* all four contracts contained the following "Examination of records by Comptroller General" clause:

"The contractor agrees that the Comptroller General of the United States or any of his duly authorized representatives shall, until the expiration of three years after final payment under this contract . . . have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor involving transactions related to this contract."

(A112). The Comptroller's request for records was made within three years of final payment. A more detailed description of the contract numbers, dates of awards, contract prices and payment status appears in the affidavit of John Brosnan (A100-A104).

#### 1. The Comptroller's Request for Information

Following discussions with representatives of the Pharmaceutical Manufacturers Association and several of

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\* A negotiated Government contract is a statutorily authorized method of procurement that may be used in situations where the formal public advertising and competitive bidding procedure is deemed impractical or unnecessary. See 10 U.S.C. § 2304(a); 41 U.S.C. § 252(c).

\*\* The relevant statutory provisions are 10 U.S.C. § 2313(b), governing the Defense Department contracts, and 41 U.S.C. § 254(c), governing the VA contract.



its member firms about a proposed study of federal drug procurement, GAO representatives visited the facilities of six drug manufacturers including Bristol (A106). While the drug companies supplied GAO's representatives with general cost data, none was willing to furnish detailed cost data. As a result, the GAO sent Bristol and five other companies a formal request for access to cost records (*Id.*). Specifically with respect to the four subject contracts, the Comptroller requested that Bristol, pursuant to 31 U.S.C. §§ 53 and 67, 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c):

[M]ake available to the General Accounting Office as required, all books, documents, papers, and other records directly pertinent to the contracts, which include, but are not limited to (1) records of experienced costs including costs of direct materials, direct labor, overhead, and other pertinent corporate costs, (2) support for prices charged to the Government, and (3) such other information as may be necessary for use to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government's interests.

(A72).

On February 10 and 11, 1975, GAO representatives met with officials from Bristol in Syracuse, New York. During that visit, Bristol stated that it would make available for examination and verification only those records it "deemed pertinent". Specifically, Bristol offered to show the GAO "(1) Bristol's contract files which included shipment and invoice records, (2) records and data relating to manufacturing costs assigned by the firm [Bristol] to the products purchased under the contracts and (3) Bristol's product prices to its non-Federal customers" (A81). Bristol refused to make available records concerning costs incurred for research and develop-

ment, marketing and promotion, and distribution and administration, on the ground that such costs are not assigned to individual products and are not pertinent to the subject contracts. Similarly, Bristol refused to produce records relating to the methodology for and decisions establishing the prices for the products sold under the four contracts. (*Id.*)

Comptroller Staats determined that Bristol's limited response was not in compliance with the GAO's statutory authority granting access and that the GAO could not fulfill its obligations to Congress if greater access were not afforded to it. Accordingly, the Comptroller informed Bristol that the GAO would take appropriate action under the contracts and such action as was necessary to execute its statutory responsibilities if greater cooperation were not forthcoming. Thereafter, Bristol commenced this lawsuit (A83-A84).

## **2. Bristol's Accounting Method**

Bristol's accounting system is described as "a full absorption manufacturing cost system" (A143).<sup>\*</sup> Bristol estimates the standard costs for each product it produces (A137, 139, 140, 145). These standard costs include direct manufacturing costs and manufacturing overhead (A148). Any deviations from these estimated standard costs are termed "variances" and are accumulated as they occur in a central variance account (A145, 149). Bristol also calculates its royalty costs by product. However, royalty costs are not included in Bristol's standard costs (A145, 148-49).

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<sup>\*</sup> This description of Bristol's Accounting System is based upon the deposition of Richard J. Cormier, Vice-President and Comptroller of Bristol (A119-A173), conducted by the Government on April 6, 1976 following the District Court's first opinion in this case, which found a "factual dispute concerning Bristol's actual accounting and business procedures", preventing the award of summary judgment to either party.

For external accounting purposes, general and administrative, research and development, and advertising and promotion costs are not allocated to products and are accumulated *in toto* by Bristol (A147-48). Research and development costs are treated as period expenses (A153). Although Bristol does not identify these costs by product for external accounting purposes, it does, at times, allocate these costs to products for internal purposes. For example, for reports used for compensation purposes there is an attempt to identify some advertising and promotion costs by product (A150). Similarly, certain distribution, sales and marketing costs are internally allocated to specific products (A152). Also, during the past year and a half Bristol has made efforts to estimate costs of research for specific products and in cases where other divisions or subsidiaries of Bristol-Myers Company request services from Bristol's Research and Development group or when research expenditures are classed as future product investment, Bristol's accounting system does allocate those costs to other divisions and subsidiaries of Bristol-Myers Company (A153-A154).

To set a selling price for ethical pharmaceuticals Bristol considers its estimated standard costs, competitive product pricing and Bristol's own pricing of similar products (A137, 158). Bristol denies that there is any minimum gross margin figure that it must recover before it will sell a product (A159). Bristol further disclaims any ability to determine the profitability of any particular drug (A163, 164).

Regardless of Bristol's accounting methods, its sales revenues are of course affected by the prices it charges for its products (A164). Revenues from government sales are commingled with revenues from non-government sales (A166). Moreover, the costs for the non-allocated expenses, such as research and development expenses, are recovered from government as well as non-



government revenues even though they are not assigned or identified with any particular product line or product (A167-68).

## **ARGUMENT**

### **The Government Is Entitled To Examine The Records Requested From Bristol.**

The issue presented by this appeal is a straightforward one. In enacting the statutory requirement of government access to corporate records directly pertaining to government contracts and related transactions, Congress sought to assure that the federal government would be able to determine whether the prices that it pays pursuant to negotiated contracts are excessive and whether the system of negotiating such contracts leads to wastefulness in government expenditures. Access to records concerning the manufacturer's major cost items is necessary to determine the relationship between the manufacturer's prices and his expenses and thus whether the prices charged fairly represent his actual costs. By denying the Government the ability to review the manufacturer's records concerning expenditures for research and development, marketing and promotion, and distribution and administration, all of which constitute a substantial proportion of Bristol's actual costs in supplying and distributing ethical pharmaceuticals, the District Court has in effect denied the GAO the ability to carry out its mandate under the applicable statutes. Moreover, by resting its construction of the scope of statutory access in large measure on the fact that Bristol's particular accounting system does not ordinarily allocate these costs to specific products, the District Court has conditioned the Government's ability to monitor the efficiency of its procurement process upon the irrelevant and fortuitous circumstance of how the manufacturer maintains its books. Such a result, which has been rejected by every appellate court

to consider the issue, is inconsistent with the wording of the statutes at issue, subverts the clearly expressed intent of Congress in enacting the access provisions and is not compelled, as suggested by the District Court, under applicable rules of contract law.

**A. The Language of the Statute and the Contracts Give the Comptroller General the Right to Examine the Requested Records.**

Section 2313(b) of Title 10 of the United States Code, applicable to the Defense Supply Agency contracts, provides:

Except as provided in subsection (c), each contract negotiated under this chapter shall provide that the Comptroller General and his representatives are entitled, until the expiration of three years after final payment, to examine any books, documents, papers, or records of the contractor, or any of his subcontractors, that directly pertain to, and involve transactions relating to, the contract or sub-contract.

Similarly, Section 254(c) of Title 41, applicable to the Veterans Administration contract, provides:

All contracts negotiated without advertising pursuant to authority contained in this Act shall include a clause to the effect that the Comptroller General of the United States or any of his duly authorized representatives shall until the expiration of three years after final payment have access to and the right to examine any directly pertinent books, documents, papers, and records of the contractor or any of his subcontractors engaged in the performance of and involving transactions related to such contracts or subcontracts.



Thus 41 U.S.C. 254(c) and 10 U.S.C. 2313(b) employ virtually identical words; it is clear no difference in meaning is intended. Consistent with these statutory provisions, each of the contracts at issue in this case provides, in relevant part, that the Comptroller General and his representatives for a period of three years after final payment shall have access to and the right to examine:

“any directly pertinent books, documents, papers, and records of the Contractor involving transactions related to this contract.”

(A112).

Bristol takes the position that the Government is seeking records\* that do not directly pertain to or involve transactions relating to the subject contract. Bristol contends that a directly pertinent record “must *directly* pertain to those costs incurred in the course of plaintiff’s transactions or activities which were *related to* the supplying of items purchased under the subject contracts or which were factors in *pricing* such items” (emphasis in original) (R. 30, p. 2). As noted earlier, the specific point of controversy is whether the Government is entitled to access to data respecting research and development, marketing and promotion, and distribution and administration costs. Bristol claims that such records are “too remote” (428 F. Supp. at 1390; A10) in that Bristol does not allocate such costs to the subject contracts and in that it does not consider such costs in setting prices to the

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\* The Comptroller’s request was as follows:

“We must request that you have the responsible officials at Bristol Laboratories make available to the General Accounting Office as required, all books, documents, papers, and other records directly pertinent to the contracts, which include, but are not limited to (1) records of experienced costs including costs of direct materials, direct labor, overhead, and other pertinent corporate costs, (2) support for prices charged to the Government, and (3) such other information as may be necessary for use to review the reasonableness of the contract prices and the adequacy of the protection afforded the Government’s interests.”

(A72).



Government. In upholding Bristol's claim the District Court found that the Government's position did not give sufficient consideration to the words of the statute and contracts, which it described as "words of limitation", and gave the Government virtually unfettered discretion.

The Government respectfully submits that this result misapprehends the plain meaning of the statutes and is contrary to the statutory purpose. We urge this Court to reverse the District Court's decision and to adopt the three other appellate decisions which have considered the scope of the access-to-records provision here involved and have sustained the Government's interpretation and granted in full the access sought by the Comptroller General. See *Eli Lilly & Co. v. Staats*, 574 F.2d 904 (7th Cir.), cert. denied, 99 S.Ct. 362 (1978); *United States v. Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979); *Hewlett Packard Co. v. United States*, 385 F.2d 1013 (9th Cir. 1967), cert. denied, 390 U.S. 988 (1968). The *Lilly* and *Abbott* cases involved pharmaceutical companies and are on "all-fours" with the instant case. Since the access to records clause is standard nationwide and mandated by statute, it is obviously desirable that the scope of the access granted by the provision be uniform on a nationwide basis. See *Illinois v. City of Milwaukee*, 406 U.S. 91, 105 n.6 (1972); *Clearfield Trust Co. v. United States*, 318 U.S. 363, 367 (1943).

The Seventh Circuit in *Lilly* squarely faced Bristol's argument on the meaning of the words "directly pertinent" and rejected the holding below in this case. Noting that in the pharmaceutical industry manufacturing and distribution costs may constitute as little as nine percent of the product's sale price,\* 574 F.2d 913, the *Lilly* court concluded:

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\* Equally significant is the amount which the industry expends on such disputed items as research and development. According to the Pharmaceutical Manufacturers Association's Annual Survey Report '71-'72, over-the-counter ethical and prescription drug manufacturers expended 11.9 percent of sales revenues on research and development (A107).

Although it might be possible to argue in other industries that costs such as research and development have such a small impact that they are not "directly pertinent" to the contract and its price, research and other costs not immediately attributable to one product form such a large portion of the costs of a pharmaceutical product that their import to such a contract seems inescapable.

574 F.2d at 913-914. Continuing, the *Lilly* court rejected the argument that its position did not fully consider the phrase "directly pertinent" as words of limitation:

In response to plaintiff's argument that including these items would not give full effect to the limits on disclosure implied by the use of the word "directly," without disputing that "directness" is a difficult concept to define, it should be noted that costs such as research and development at the least appear to have a logical, causal and consequential relationship to a portion of the price of the products purchased by the Government.

574 F.2d at 914 (footnote omitted).

Likewise, the Seventh Circuit rejected the argument that the costs sought by the Comptroller are "remote":

Further, contrary to plaintiff's contention, such costs are not "remote" within the established definitions of that term in relation to at least a portion of the price because their inclusion in the price of the product is not unforeseeable once the costs are incurred, nor is their impact on a part of the price significantly altered by any intervening cause. See generally W. Prosser, *Law of Torts* § 42 (4th ed. 1971).

574 F.2d at 914.

Accordingly, the Seventh Circuit concluded, and we urge this Court to do likewise, that records of research and development, marketing and promotion, and distribution and administration costs are "directly pertinent" to the subject contracts even if they are not allocated to an individual contract.\*

If such costs constituted a minimal share of the total price of the contract, it might be difficult to argue that these costs are "directly pertinent" to the price of the contract as a whole, but that issue does not seem to be presented on these facts. Thus in relation to the contract as a whole, these costs fit within the common and legal understandings of "directly pertinent". The mere fact that, as plaintiff asserts, it does not or even could not allocate costs such as research and development to an individual contract does not undercut the proposition that those costs are directly pertinent to an individual contract but merely indicates that they are directly pertinent to more than one individual contract.

574 F.2d 914.\*\*

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\* The District Judge agreed with the Government that "the issue should not depend entirely on a contractor's bookkeeping method, i.e., whether it does or does not assign particular costs to particular contracts or products." (428 F. Supp. at 1391; A15). Ironically, however, the Government was not afforded access to any records of costs which Bristol does not in fact assign.

\*\* If there were any room for doubt as to the application of the *Lilly* opinion to the cost items at issue here, it was dispelled by the Seventh Circuit's subsequent opinion in *United States of America v. Abbott Laboratories*, 597 F.2d 672 (7th Cir. 1979), which, after describing *Abbott* as a case "identical" to *Lilly*, concluded:

The initial demand for information by the Comptroller General was phrased in exactly the same words as in this case, *id.* at 906, and was approved by this court in *Lilly* as

[Footnote continued on following page]



**B. The Government's Position is Supported by the Legislative History and Serves the Congressional Purpose as Interpreted by the Case Law.**

In 1951 Congress amended the Armed Services Procurement Act of 1947 and the Federal Property and Administrative Services Act of 1949 to require insertion of "access-to-records" provisions in all government contracts negotiated under those statutes.\* Pub.L. No. 82-245, 65 Stat. 700. These amendments are codified at 41 U.S.C. § 254(c) and 10 U.S.C. § 2313(b).

The legislative history makes plain that Congress envisioned and sought to encourage detailed government inquiry into the economic efficiency of the negotiated con-

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consistent with the statutory and contractual provisions. *Id.* at 912-14. Specifically, we construed the language "directly pertinent . . . to the contract" to permit government access to information that "is a significant input to the cost of the product purchased in the contract." *Id.* at 914-15. In so doing, we rejected contentions that this language limited the government's inquiry to only those items specifically assigned by the company as costs of the contract or to information relating to possible improprieties in the negotiating process. Thus, the government's demands for information relating to costs of research and development, marketing, promotion, distribution and administration were held to be proper.

597 F.2d at 674.

\* The new law required contractual provisions that would provide access not only to the contractor's books, documents, papers, or records, but also to similar materials in the possession of subcontractors. In other words, if a contractor entered into any subcontracts in connection with the performance of its duties under a government contract governed by Pub. L. No. 82-245, it would include in those subcontracts a provision guaranteeing the Comptroller General's access to the subcontractor's pertinent records. Congress would have had no reason to require such provisions for subcontractors if it did not contemplate an investigation of the costs incurred by contractors supplying the government under negotiated contracts.

tract procurement method.\* This inquiry requires such access to suppliers' cost records as would permit a valid evaluation of the prices charged. Only through examination of such records will the Comptroller General be able to determine whether the government should continue to procure particular items under negotiated contracts or whether some other procurement method (*e.g.*, formal advertising) might permit the government to obtain the same items at reduced expense.

Representative Hardy, the sponsor of the 1951 amendment, stated that the bill had a twofold aim: "one, to give the Comptroller General the proper tools to do the job the Congress had instructed him to do; and, two, to provide a deterrent to improprieties and wastefulness in the negotiation of contracts." 97 Cong. Rec. 13198 (1951).\*\*

After reviewing the legislative history of the access-to-records provisions, the Seventh Circuit in *Lilly* summarized its findings:

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\* Report No. 603, 82nd Cong., 1st Sess. 4 (1951) (accompanying Senate Bill 921) states the purpose of the statute:

The Federal Property and Administrative Services Act of 1949 and the Armed Services Procurement Act of 1947 are general legislation of permanent application to a very large percentage of Government procurement. They authorize negotiation of contracts without advertising under certain specified circumstances in the discretion of the agency head. Since it is well recognized that negotiated contracts are at the same time effective procurement instrumentalities under special circumstances, and require close supervision and control, this legislation would make examination by the Comptroller General a permanent part of procurement procedure on a basis of broad application. This bill would have the effect of extending the examination provisions added to the First War Powers Act by Public Law 921 of the Eighty-first Congress.

\*\* Congressman Hardy also noted:

This bill would at least enable the agent of the Congress to check the transaction, both from the Government records and the contractor's books. (97 Cong. Rec. 13198).

Despite its brevity, the legislative history of Sections 2313 and 254 lends support to the Comptroller General's contention that an inquiry into whether costs are excessive was intended by the drafters of those bills. The sponsor of the legislation, Congressman Hardy, made this added purpose apparent when he explained that under its new authority the GAO would "find [whether] the rates [prices] were excessive" and that in addition to deterring improprieties the new authority also would deter "wastefulness in the negotiation of contracts." 97 Cong. Rec. 13198. Consistent with this purpose, Congressman Hardy recognized the GAO's authority "to look behind the rate [price] which had been established." *Id.*

574 F.2d at 915 (footnote omitted).

In short, the fundamental congressional purpose in requiring the access-to-records provision in each negotiated contract was to give access to information which might lead to the elimination of "wastefulness in the negotiation of contracts" (Congressman Hardy, 97 Cong. Rec. 13198). If Bristol's total costs are substantially lower than the prices paid by the Government, the Comptroller General may recommend that the Defense Department and Veterans Administration adopt different procurement methods in the future. This reasoning was explicitly adopted by the other courts of appeals that have considered the question presented here. See, e.g., *Hewlett-Packard Co. v. United States*, 385 F.2d 1013, 1016 (9th Cir. 1967), *cert. denied*, 390 U.S. 988 (1968). In this regard, it should make no difference whether the manufacturer allocates his costs to specific products for accounting purposes, or indeed whether he takes these costs into consideration in setting his prices. GAO's responsibility is to determine whether the total underlying costs of supplying the drugs contracted for—however they are viewed or treated by the manufacturer—justify the price charged.



The District Court here dismissed the Government's reliance on *Hewlett-Packard*, which prior to *Lilly* was the only reported appellate decision construing the access-to-records clause, stating that since it specifically dealt only with production costs (not in issue here) that it was "of no positive aid in resolving the instant controversy."\* 428 F. Supp. at 1391 (A14). In this regard, too, the *Lilly* court rejected the District Court's analysis:

While it is true that the district court's order affirmed by the Ninth Circuit in *Hewlett-Packard* went no further than declaring that the Comptroller General could examine any records relating to "the cost of producing the items" furnished under the contracts, the scope of the order in that case and, more importantly, the reasoning of the reviewing court do not seem to be significantly different from the Comptroller General's position here. Plaintiff's observation that the *Hewlett-Packard* order did not expressly include reference to costs not assigned by the firm to individual products and pricing information is not persuasive both because the order included overhead costs, a type of cost that is not always assignable to individual products, and because the rationale of the Ninth Circuit's opinion, which emphasized the appropriateness of inquiry into the procurement process as a whole, was not limited to disclosure of the specific costs requested by the Comptroller General in that particular case. . . .

At least as applied to the pharmaceutical industry, we think that the broad reading of *Hewlett-Packard* is the reading most consistent with the plain meaning of the statutory language and with the legislative history. In interpreting the statu-

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\* The demand for records made by the Comptroller to *Hewlett-Packard*, 385 F.2d at 1015, parallels the demand made upon *Bristol* and the other drug companies.

tory language, as the Comptroller General contends, "it is hard to imagine anything more directly related to a contract than the cost of producing the items covered by it or the matters going into the makeup of the price" (Reply Br. 9). Accord, *Hewlett-Packard supra*, at 1016.

574 F.2d at 913.

Moreover, Public Law 82-245 has not been amended except to the extent of an immaterial language change adopted at 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c) and the legislation's effect has not been modified or otherwise changed by subsequent legislation. This is particularly significant because Congress has been apprised of the GAO's long-standing administrative interpretation of the statutes and of the *Hewlett-Packard* decision and the Government's understanding and application thereof. Courts have traditionally shown great deference to the contemporaneous administrative interpretation given by the agency charged with administering a statute (e.g. *Udall v. Tallman*, 380 U.S. 1 (1965)) and have sustained such interpretations when they have been brought to the attention of Congress and remained undisturbed. See, e.g., *Power Reactor Development Co. v. International Union of Electrical, Radio and Machine Workers*, 367 U.S. 396, 408, 413-14 (1961); *Kay v. Federal Communications Commission*, 443 F.2d 638, 646-47 (D.C. Cir. 1970).

There is ample evidence of Congressional concurrence with the administrative interpretation of the statute and the contract provisions urged here by the Government. In hearings held in May 1963, before the Subcommittee for Special Investigations of the House of Representatives' Committee on Armed Services, Robert Keller, then General Counsel of the General Accounting Office, stated at length the basis for the Comptroller General's interpretation of the access-to-records clause included in the contracts negotiated with the Government. He offered a succinct statement of the agency's position:

It is our position that the contract clause and the statute give us the right to examine the cost records of the contractor and other pertinent data that relates to the items included in the contract, in sufficient completeness and detail to permit us to determine the reasonableness of the negotiated prices.

We believe our position is supported by the language of 10 U.S.C. 2313(b) and the contract provision and, to an even greater extent, by the legislative history of the statute . . . .

*Hearings Before the Subcommittee for Special Investigations of the House Committee on Armed Services, under the Authority of H. Res. 84, 88th Cong., 1st Sess. 10 (1963).*

At the conclusion of Mr. Keller's statement Congressman Hardy, the Chairman of the Subcommittee and an author of the amendment requiring the inclusion of an access-to-records clause in defense contracts, stated as follows:

Thank you Mr. Keller. I think you have stated this case very well as to the necessity for having a contract provision permitting audits of negotiated contracts.

*Id.* at 23.

Furthermore, Congress has been made specifically aware of the *Hewlett-Packard* decision upholding the Government's interpretation of the statute and the access-to-records clause. During the course of hearings before the Subcommittee on Monopoly of the Select Committee on Small Business, United States Senate, held in January, 1971, Mr. Paul Shnitzer, Assistant General Counsel, in commenting on GAO's administrative position concerning the access-to-records clause, stated as follows:



What I am saying is, and we do have a case which ultimately went up as far as the Supreme Court, is that under our 1951 authority, the contract is required to include a provision which gives the GAO the right to examine records of costs, direct and indirect generated in the performance of that contract. So if a contract is awarded to company A and it comes within the purview of this—it is a negotiated contract for, let us assume, \$100,000—we would have a right then to go back and examine the records of company A—the cost records, direct and indirect, to determine how much it cost him to perform that contract . . . .

*Hearings on Competitive Problems in the Drug Industry Before Subcommittee on Monopoly of the Senate Select Committee on Small Business, 92d Cong., 1st Sess. 8018-19 (1971).*

Thus, since the enactment of 10 U.S.C. § 2313(b) and 41 U.S.C. § 254(c), Congress has concurred in the administrative construction of the statute and utilization of the access-to-records clause. Therefore, under these circumstances, GAO's longstanding administrative construction of the statute should be sustained.

### **C. The District Court's Contractual Analysis is Erroneous.**

A second prong of the District Court's ruling rejecting the Government's demand for access to records of costs of research and development, marketing and promotion and distribution and administration was its conclusion that as a matter of contract construction Bristol could not have understood the access-to-records clause as authorizing such access.\*

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\* Although not discussed explicitly, the District Court's conclusion on this point was no doubt influenced by its belief that *Hewlett Packard Co. v. United States*, *supra*, 385 F.2d 1013, was of

[Footnote continued on following page]

The Government agrees with the District Court that a contractual analysis is appropriate. The contract (irrespective of its statutory origin) should be enforced since Bristol executed the contracts voluntarily and knew or should have known of the Government's construction of the access-to-records clause and of the reading of that clause in the *Hewlett-Packard* case.\*

The access-to-records clause, standard in form, nationwide in application, has been widely used by the Government to examine similar records of other contractors with beneficial results to the public. As the affidavit of Paul R. Dembling, General Counsel of the GAO, attests:

The access-to-records clause and the statute requiring its inclusion in negotiated contracts has been consistently used by the Comptroller General since enactment of the statute; and I know of no official congressional action to modify the statute or the access-to-records clause to limit their interpretation as asserted by the Comptroller General.

(A108).

In addition, the GAO has freely acknowledged to Congress its views about the scope of the *Hewlett-Packard* decision and the breadth of that opinion has been recognized. See Cibinic and Lasken, *The Comptroller General and Government Contracts*, 38 Geo. Wash. L. Rev. 349, 388 (1970):

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"no positive aid in resolving the instant controversy." As was discussed above, the Government submits that the District Court misapprehended the scope of the *Hewlett-Packard* decision and that properly understood that opinion put Bristol on notice of the Government's position.

\* Since the contract provision involved here is required by statute, there can, of course, be no issue of bargaining as to the terms of the clauses nor any contention that Bristol was unaware of their import. See *United States v. Wunderlich*, 342 U.S. 98 (1951); *G.L. Christian & Associates v. United States*, 320 F.2d 345 (Ct. Cl.), cert. denied, 375 U.S. 954 (1963).

Armed with this provision, the Comptroller General has delved into contractor's books and records. Just how far the contractual provision required by statute permits the Comptroller General to go was decided in *Hewlett-Packard Co. v. United States* [footnote omitted] . . .

Thus, the present case falls squarely within the well-established rule:

Where the same words have for many years received a judicial construction, the court will suppose that the parties have contracted upon the belief that their words will be understood in the accepted legal sense.

Chitty on Contracts, ¶ 613, at p. 288. (23d Ed. 1968) (footnote omitted). This principle is especially applicable to Government contracts. See *Stencel Aero Engineering Corp. v. United States*, 431 U.S. 666, 674 n.8 (1977); *Bowers Dredging Co. v. United States*, 211 U.S. 176 (1908).

Accordingly, the Government submits that the Seventh Circuit in *Lilly* was clearly correct when it rejected the District Court's contractual analysis in this case:

Focusing on the contractual nature of access-to-records clause, plaintiff lastly relies on language in *Bristol* and *Merck* that the interpretation of any contractual provision turns on the intent and understanding of the parties involved and that "it is inconceivable" that a contracting firm would have understood the clause in the manner in which the Government now interprets it. See e.g., *Merck*, *supra*, mem. op. at 5. Even assuming that Lilly's understanding would be controlling, we disagree with the *Bristol* and *Merck* language, at least as applied to this case, since the contracts at issue were signed after the landmark *Hewlett-Packard* decision and Lilly knew that the



Government's similar position was adopted there or at least is chargeable with that knowledge. See *Stencel Aero Engineering Corp. v. United States*, 431 U.S. 666, 674 n. 8., 97 S. Ct. 2054, 52 L. Ed. 2d 665.

574 F.2d at 918.

## CONCLUSION

**The District Court's decision should be reversed and judgment entered for the Government granting the relief requested in its counterclaim.**

Dated: New York, New York  
November, 1979

Respectfully submitted,

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AFFIDAVIT OF MAILING

State of New York            )  
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Pauline P. Troia  
deposes and says that       s he is employed in the Office of the United States  
Attorney for the Southern District of New York.                               being duly sworn,

That on the  
2 copies  
7th day of December 19 79 s he served a copy of the within  
(govt.) brief of applts. Comptroller Gen. of the US and the USA and the  
appendix  
by placing the same in a properly postpaid franked envelope addressed:

Weil, Guttman & Davis, Esqs.,  
60 East 42nd St.  
New York, NY 10017

And deponent further says       s he  
sealed the said envelope       and placed the same in the mail chute drop for  
mailing in the United States Courthouse Annex, One St. Andrews Plaza, Borough  
of Manhattan, City of New York.

Sworn to before me this  
7th day of December, 19 79

*Ralph Lee*

*Pauline P. Troia*